



CommBank Legal Market Pulse.

December 2018



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Key insights

Planning for an ever-changing future

In this edition of the CommBank Legal Market Pulse, we examine the strategies that firms are using to keep pace with clients and competitors.

Key insights

Welcome to the 2018 edition of the CommBank Legal Market Pulse, our annual analysis of the trends shaping the legal services industry in Australia.

In this year's edition, we turn the spotlight on the way in which firms are future-proofing their operations in response to ongoing changes to client engagement and the industry more broadly.

Currently, larger firms are enjoying the benefits of heightened client demand driven by activity across practice areas including disputes, regulatory activity in the Banking and Aged Care sector and strong corporate deal flow.

As a result, sentiment among law firms is exceptionally positive, particularly for top-tier firms. In fact, firms across the industry have adopted the most bullish stance on the performance of both the broader economy and the legal services market ever recorded in the Legal Market Pulse research series.

Heightened client demand* is also providing a moderate reprieve from some of the longest-standing challenges facing the industry, such as negotiating prices and winning business.

While firms are benefitting from robust conditions, translating to a tangible uplift in revenues and profits, the medium-term outlook is more subdued.

However, as many firms have increased their headcount to service greater demand, attracting and retaining top talent has become one of the most significant challenges.

Many firms are also looking beyond the strength of the current legal services market and focusing on how to manage their longer-term sustainability to deliver growth.

When considering their future strategy, firms are most likely to be responding to two dominant forces - changes in client expectations and competitive pressures.

In particular, the research has highlighted an acute awareness among firms of the increasing power wielded by buyers of legal services and their ability to drive rates down, request more for less and breed competitive tension.

Encouragingly, many firms are responding to changing client expectations and implementing a range of strategies to address these and other pressures.

These include a focus on attractive work environments and lateral hiring, taking a flexible approach to fee arrangements and using technology to drive operational efficiencies and enhance client service.

As the top area of planned investment in the year ahead, and with improving returns on investment, many firms are seeking to accelerate adoption in most technology categories.

While the top-tier firms have led adoption of most technologies in recent years, particularly in cloud-based solutions, more mid-tier firms are now looking to increase their technology spend. The key focus for these firms is in emerging areas such as data analytics, artificial intelligence and blockchain to keep pace with competitors and clients.

We hope you find this year's edition of the CommBank Legal Market Pulse useful within your firm's planning and benchmarking activities. We look forward to discussing these insights and hearing from you first hand about your experiences in a dynamic and ever-changing market.

Marc Totaro

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*Across the legal sector, the number of firms with a positive view on the performance of the economy over the next 12 months has more than doubled from 30% in 2017 to 63% in 2018. In line with last year's research, only 5% of firms expect the broader economy to perform negatively in the year ahead.

About the CommBank Legal Market Pulse Report

CommBank Legal Market Pulse is a wide-ranging analysis of the of the Australian legal sector. The report is based on a quantitative survey of CEOs, Managing Partners and other senior leaders. Forty-one law firms participated in the survey for this edition, carried out in August and September 2018 by Beaton. Participants include 10 respondents classified as top-tier firms and 31 respondents classified as mid-tier firms. When results are split by tier of firm, counts are shown due to small sample sizes. Where a 'don't know' response was given it is excluded from the chart.

Key insights

★ Business confidence

Net percentage (proportion of firms that answered positive minus the proportion of firms that answered negative)

	2018	2017
Now	85%	20%
Next 12 months	63%	25%
Next 24 months	37%	15%

📈 Profit growth

(Year-on-year growth comparison)

	2018	2017
Profit (all firms)	8.2%	1.3%
Top-tier	10.7%	2.3%
Mid-tier	7.4%	1.1%

🔗 Top 3 business challenges

Net percentage (proportion of firms that answered easy minus the proportion of firms that answered challenging)

	2018	2017
Negotiating prices with clients	-54%	-68%
Finding quality staff	-63%	-25%
Winning new business	-39%	-58%

📅 12-month outlook for expenses

Net percentage (proportion of firms that answered increasing minus the proportion of firms that answered decreasing)

	2018	2017
Salaries	100%	N/A
IT Hardware/software	73%	60%
Marketing and business development	54%	55%

🌱 Top considerations when managing firms' futures

Net percentage (proportion of firms that indicated high consideration)

	Top-tier	Mid-tier
Increasing client demands	7 in 10	20 in 31
Downward pressure on fees	6 in 10	17 in 31
Clients willing to switch firms	5 in 10	17 in 31

💡 Top 5 future-proofing and revenue growth strategies

(Engaged now and will continue over next two years)

- Flexible working arrangements (100% of all firms)
- Alternative fee arrangements (95% of firms)
- Adopting new technologies (93% of firms)
- Lateral hiring (88% of firms)
- New practice areas (58% of firms)

Key insights



Return on investment in technology spend

(proportion of firms)

	2018	2017
High return	22%	8%
Moderate return	39%	43%
Low return	27%	20%
No return/ don't know	12%	29%



Technology adoption

(proportion of firms that have implemented and use frequently)

	2018	2015
Cloud-based solutions	39%	26%
E-discovery	54%	42%
Enterprise social media	24%	13%
Data analytics	29%	26%



Change in technology investment over next 2 years

Net percentage (proportion of firms that answered increasing minus the proportion of firms that answered decreasing)

- Data analytics (**79%**)
- Artificial intelligence (**78%**)
- Blockchain technology (**77%**)
- Document automation (**73%**)
- Cloud based solutions (**70%**)



The state of the market

A short-term shift in fundamentals

A robust market for legal services has helped drive law firms' confidence to new highs. However, while current conditions have helped ease some perennial concerns, firms face longer-term challenges.

Economic outlook climbs to new highs

The outlook on the economy among law firms continues to strengthen, with expectations for positive economic performance reaching its highest level since the inception of the CommBank Legal Market Pulse report in 2010.

Elevated confidence levels suggest that firms expect macroeconomic conditions to support drivers of demand. This may include increased corporate deal activity, major public sector projects and in-bound investment in Australian businesses.

Across the legal sector, the number of firms with a positive view on the performance of the economy over the next 12 months has more than doubled from 30% in 2017 to 63% in 2018. In line with last year's research, only 5% of firms expect the broader economy to perform negatively in the year ahead.

While both top- and mid-tier firms are more upbeat about the economy's prospects, a positive outlook is more pronounced among top-tier firms.

Positive sentiment is now prevalent within eight of the ten top tier firms, compared to just three of eight respondents in the previous year, and none of these firms hold a negative outlook. This is indicative of the expectation that economic conditions will continue to drive demand in areas such as corporate finance and mergers and acquisitions activities that are core to top-tier firms.

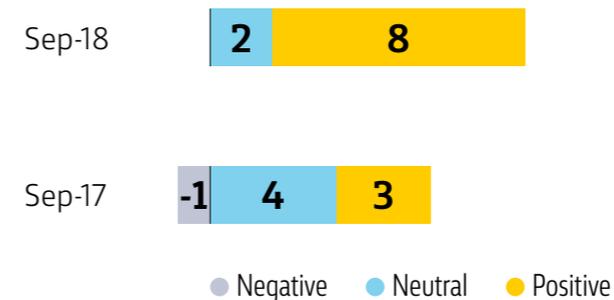
"M&A activity is running strongly and foreign investment into Australia remains high. This and continued government spending on infrastructure is likely supporting a brighter economic outlook among firms."

Marc Totaro
National Manager, Professional Services
Business & Private Banking
Commonwealth Bank of Australia

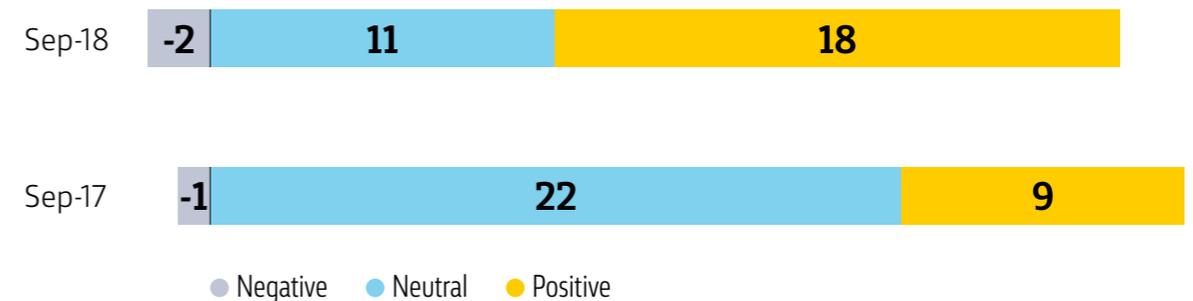
Strong economic conditions

How do you believe the broader economy in Australia will perform over the next 12 months?

Top-tier firms



Mid-tier firms



Client demand spurs short-term optimism

The improved outlook for broader economic performance is underpinning far higher confidence in short and medium term business conditions for Australian law firms.

In addition, ongoing regulatory activity in the financial services and aged care sectors, growth in class actions and disputes and elevated levels of commercial activity in practice areas related to compliance and technology appears to be driving stronger demand for legal services across the market.

As a result, 85% of firms across the sector hold a positive view on current business conditions – up from 38% a year ago. With no firms rating current conditions as negative, the net reading stands at 85%, well above the previously reported peak in 2017.

While there is a prevailing view of the strength of the current market and the outlook remains more positive than the previous year, conditions are expected to gradually ease over the next 12 to 24 months. Expected conditions in 12 months' time are net 63% and fall further to 37% over the next two years.

Top-tier firms are anticipating a sharper decline in conditions over the next two years compared with mid-tier firms, suggesting that current market activity supporting client demand is expected to taper off over the longer term.

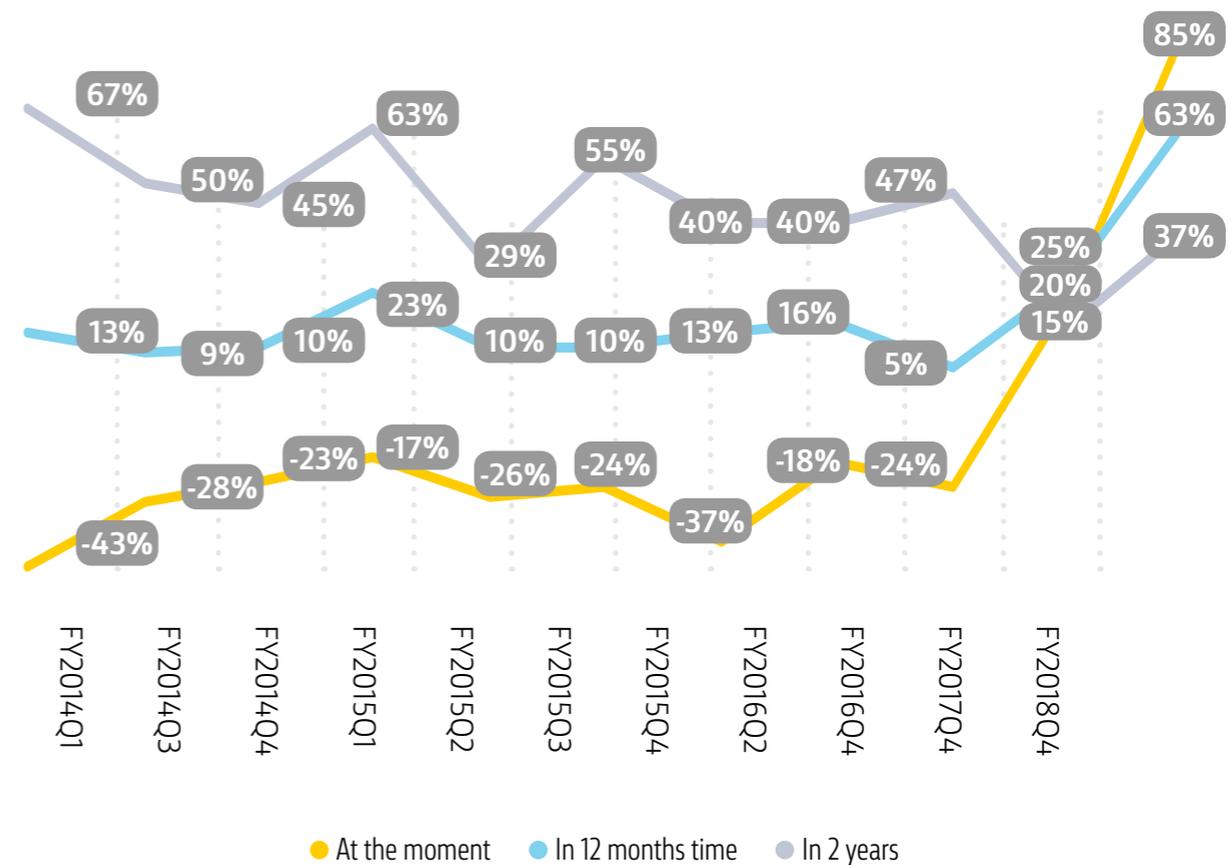
"[we are developing] a greater focus on emerging areas of business and law, as well as the next steps for some of the current issues, [rather] than just competing in the 'here and now.'"

CEO/Managing Partner
International top-tier firm

Confidence surges, but will it last?

How do you rate overall business conditions for Australian corporate and commercial law firms?

Net percentage (proportion of firms that answered positive minus the proportion of firms that answered negative).



The war for talent intensifies

Current and expected levels of client demand have driven changes to the nature and extent of challenges facing firms with notable year-on-year differences in reported conditions for specific operational and market factors.

The most common challenge among Australian firms is finding high quality staff as firms vie for top talent to service heightened demand.

As firms have increased headcount, they report that attracting quality people has become significantly more challenging over the past 12 months, with a net reading of -63% versus -25% in 2017. The top-tier firms are facing greater headwinds when attracting talent (-70%) than mid-tier firms (-61%).

Staff utilisation across the market has also eased from -35% to -2% in the same time period - now viewed by top-tier firms as the most favourable element of business conditions.

Anecdotally, some firms are also seeking to address staff attraction and retention through further embedding a strong culture of innovation in the workplace, and leveraging technology to develop commitment and drive productivity.

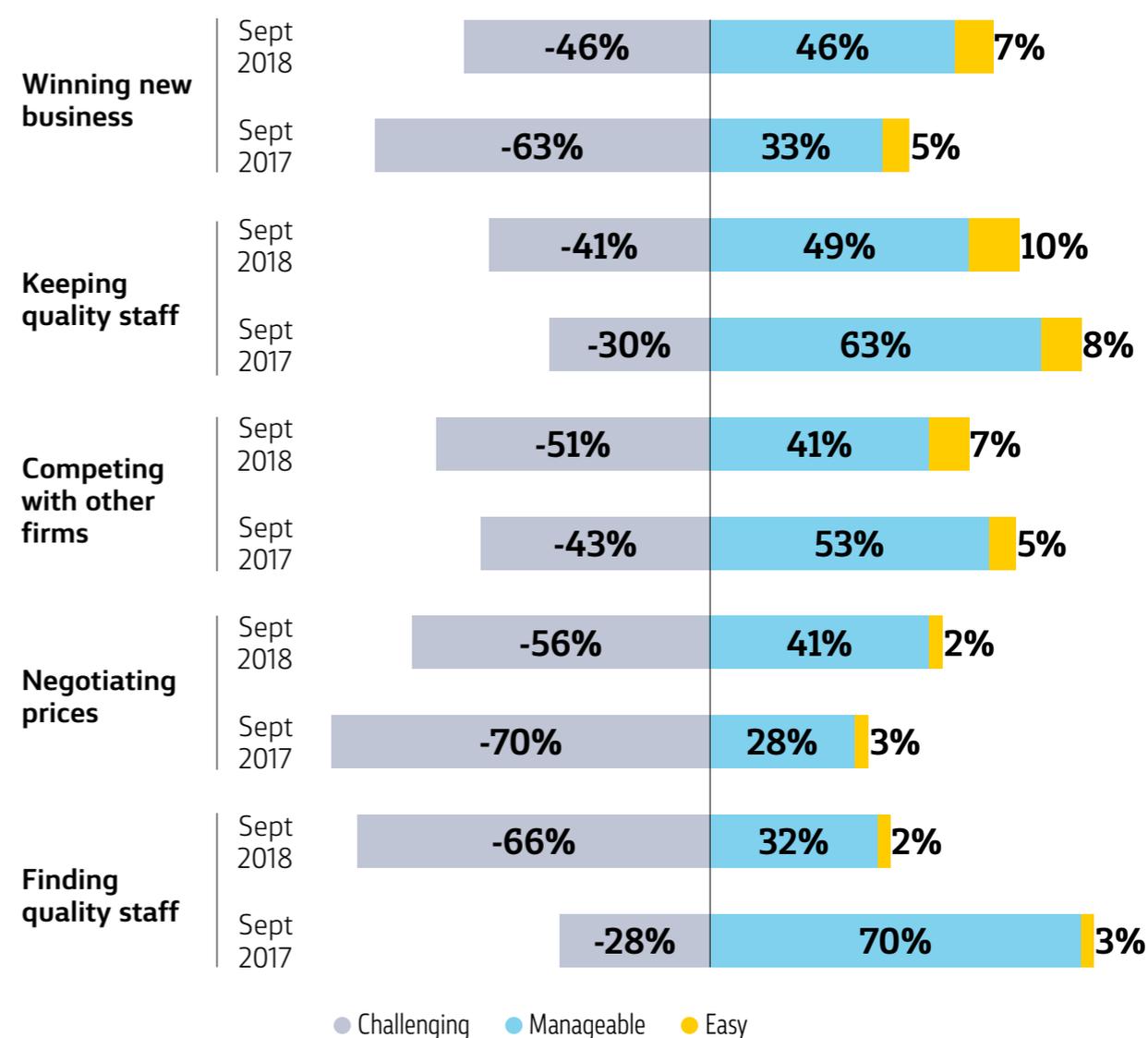
While both top-tier and mid-tier firms now find it easier to negotiate prices with clients, this remains a top-rated challenge overall. Mid-tier firms in particular view winning new business as challenging (-48%), compared with top-tier firms (-10%) that may currently enjoy a stronger pipeline of work.

"We are concentrating on the 80/20 rule [to] try to extract more work from existing clients in new areas of law. We have also incentivised partners to win new work."

Chairperson
Mid-tier firm

Top rated business challenges

How would you rate each of these elements of business conditions at the moment?



Channelling profit into planning

Stronger client demand is enhancing the financial performance of firms across the sector, with a significant increase in reported profits in the 2018 financial year. Overall, firms reported an 8.2% increase in profit between the 2017 and 2018 financial years, compared with just 1.3% profit growth in the 2016/2017 financial year.

Top-tier firms have generated a greater increase in average profit compared with their mid-tier peers, with five of the ten firms surveyed indicating more than 11% profit growth. Of these, four indicated growth of 15% or more. By comparison, 12 of the 31 mid-tier firms reported the same level of profit growth.

In line with increased firm profitability, firms have experienced rising Profit Per Equity Partner (PPEP) over the past financial year with the most significant increases seen among top-tier firms.

It appears that stronger profitability is underpinned by both growing revenues and more accurately predicting expenses, which may indicate firms have better control of their costs and are driving efficiencies through technology solutions.

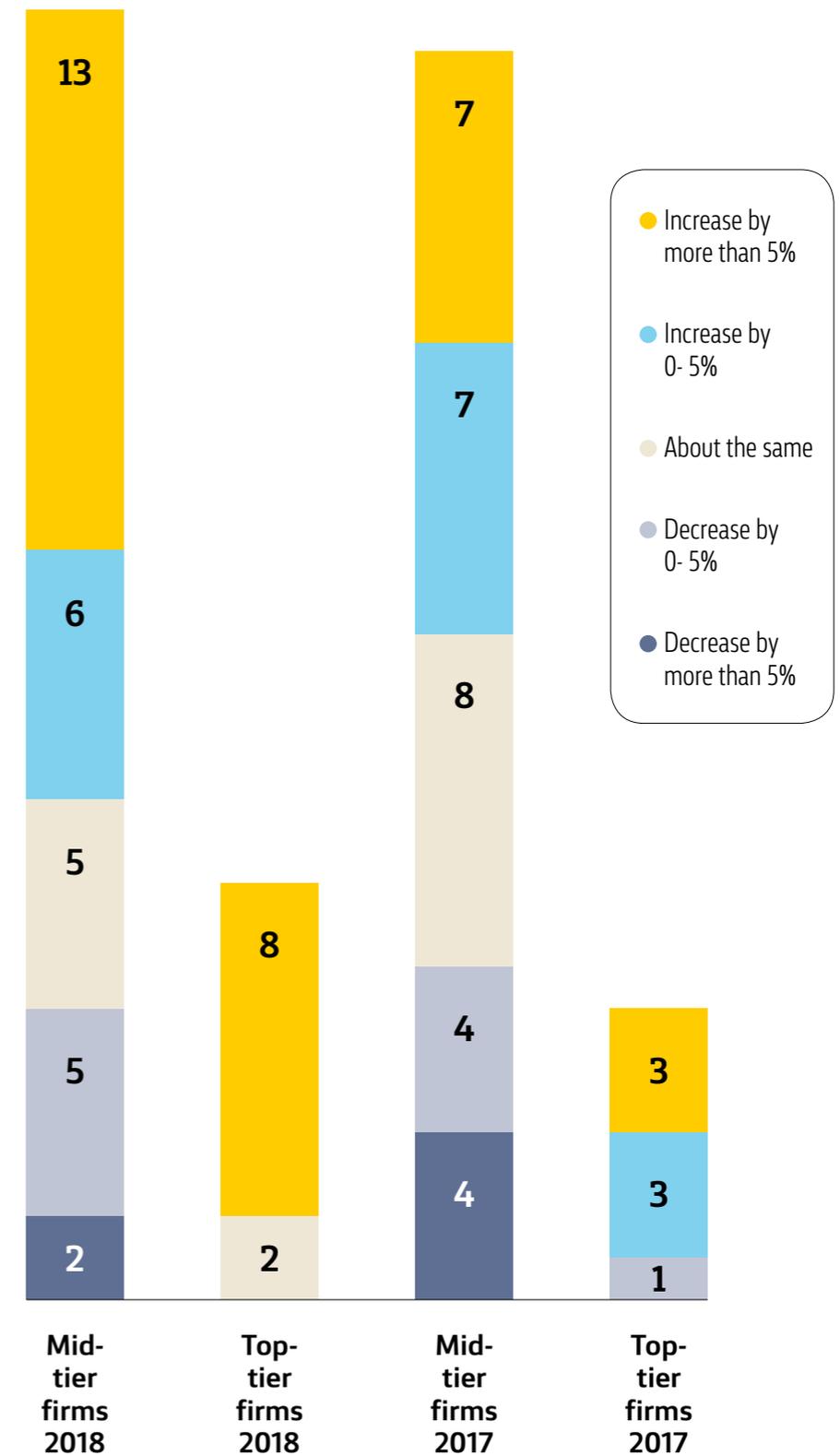
In fact, eight of 10 top-tier firms said that PPEP had increased by more than 5% as these firms distribute profits among partners. In contrast, 19 of 31 mid-tier firms experienced an increasing PPEP outweighing the seven firms that indicated that PPEP had fallen.

When considering the outlook for expenses for the next 12 months, all firms are planning to invest more heavily in salaries (net reading of 85%) technology (73%), and marketing (54%), among other areas.

"Many firms recognise the potential for heightened demand to soften over the medium term. To support ongoing performance, savvy firms are balancing the distribution of hard-earned profits to equity partners with reinvestment in the firm's ability to adapt to longer-term structural change."

Marc Totaro
National Manager, Professional Services
Business & Private Banking
Commonwealth Bank of Australia

Profit Per Equity Partner (FY17 versus FY18)





The future of law

Embracing a changing landscape

In response to changing client expectations and intense competition, many firms are exploring a range of ways to future-proof their business and develop resilience to ongoing challenges.

Buyers expected to flex their muscle

While many firms are busy responding to the more recent uplift in activity, longer-term structural changes to the industry led by shifting client expectations, heightened competition and emerging technologies continue to shape the way in which leaders are evolving their firms.

Despite considering a range of market forces when addressing the future of their firms, both top-tier and mid-tier firms rated client-led factors among the highest on their agenda. The threat of competitors equipped with tools and processes to enhance client service and efficiencies also ranked highly.

Firms identified five major drivers of client buying power as being of high net consideration (high consideration minus low consideration) with mid-tier firms more focused on managing fee related issues, while the top-tier are more likely to be responding to the clients moving activity in-house or engaging directly with outsourced service providers. These five 'levers' of buyer power include:

- 1 Clients demanding more for less (7 in 10 top-tier firms and 20 in 31 mid-tier firms indicated this was of high or very high consideration)
- 2 Downward pressure on fees (6 in 10 and 17 in 31)
- 3 Willingness to switch firms (5 in 10 and 17 in 31)
- 4 Clients in-housing work (4 in 10 and 11 in 31)
- 5 Clients directly using legal process and services outsourcing (3 in 10 and 4 in 31)

Other factors appear to be less relevant to firms' future strategies. For example, the continued expansion of the Big Four accounting and advisory firms' legal practices was one of the lowest considerations for both top-tier (-40%) and mid-tier firms (-39%). Given the scale of these firms, we expect this may become an increasing threat in future.

Similarly, they aren't too worried about the future impact of NewLaw and alternative model firms. That is particularly so among mid-tier firms that are increasingly attuned to these competitors' maturing presence in the market, and with continued merger and acquisition amongst these firms likely to continue.

Given this more established presence, there is the ongoing potential for NewLaw firms to present a gradually increasing, and continued, challenge for traditional firms.

"Adapt or die seems to be more relevant than ever; we will adapt by continuing with our technology advances especially in our high-volume practice areas; we will also adapt by creating greater channels of communication between our lawyers and our clients."

Chairperson
Mid-tier firm

Future-proofing strategies

Encouragingly, Australian law firms are already developing a range of strategies to future-proof their firms and grow revenues, often in direct response to changing client behaviours and competitive pressures.

The research shows that currently every firm engages in flexible work arrangements and will continue to do so over the next two years. This suggests that talent retention is a priority, particularly given that 88% of firms are also engaging in lateral hiring to grow revenues.

Almost all firms (95%) are also developing alternative fee arrangements in response to client pressure and 93% are adopting new technologies to adapt to changing client expectations and better compete with more flexible and efficient rivals.

While the majority of firms are already expanding into new practice areas (58%), a further 25% of firms are expected to follow within the next two years. This was the second highest emerging strategy behind adding a variable cost lawyer service. Firms were least likely to use mergers as a future-proofing strategy.

Top-tier firms are ahead of their mid-tier counterparts when it comes to future-proofing their businesses, particularly focusing on the following areas:

- Legal process and service outsourcing
- Partnering with technology start-ups
- Adding a variable cost lawyers service

However, mid-tier firms are seeking to increase engagement in almost all areas of future-proofing within the next two years. They expect to match top-tier firms in process and services outsourcing and partnering with start-ups and exceed them when it comes to entering new practice areas.

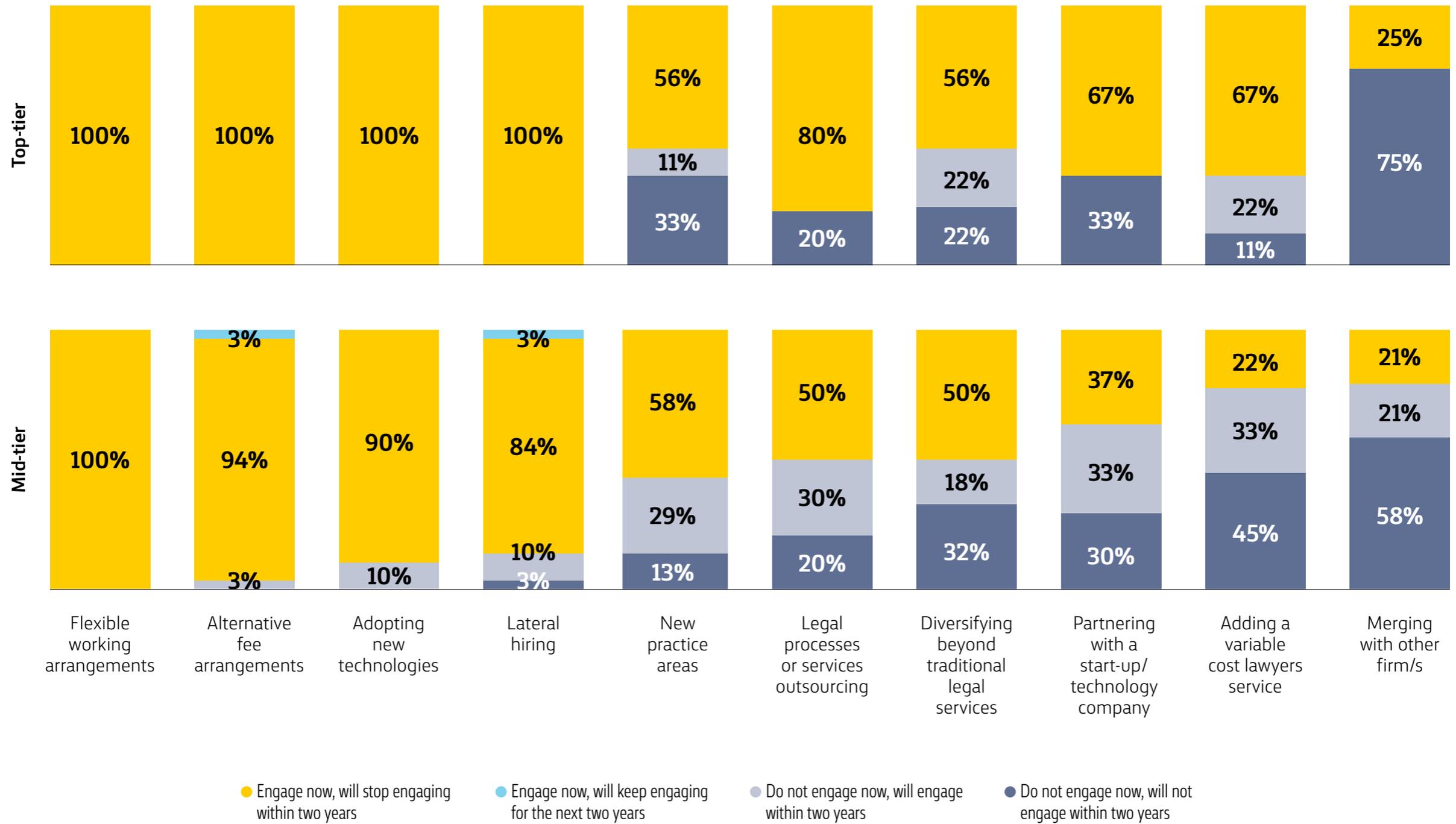
"We have invested heavily in innovation. As a global leader in legal services, we have the opportunity to offer new innovative products to our client base and, potentially, to the broader market."

CEO/Managing Partner
International Mid-tier firm



Managing future change

How your firm is engaging with future-proofing and revenue growth strategies?



Case study: Norton Rose Fulbright



Breaking with tradition at Norton Rose Fulbright

As Norton Rose Fulbright approaches the one-year anniversary of the significant merger with Henry Davis York, Partner and Deputy Chair of the firm's Australian Partnership Council, Scott Atkins, says that the firm is highly attuned to how transformation within its clients' businesses are changing the nature and delivery of legal services.

Atkins believes that while current demand is elevating optimism in the Australian legal services market to levels not seen in the past four or five years, innovation is crucial to adapt to the strategic future and "maximise the opportunities as the market continues to redefine itself."

Beyond having the right cultural framework to create a groundswell for innovation, Atkins highlights that there are already vast amounts of innovation across the sector.

Norton Rose Fulbright has initiated a global program known as 'NRF Transform', which Atkins says it is "about how we work with clients to help transform their business." "It's not just about trying to deliver the same thing at a different price, it's about redesigning the process of delivery at its most fundamental level."

As part of this program, the firm established its centre for innovation based in Newcastle in the United Kingdom. Its focus is designing new processes for the delivery of legal services, integrated with technology.

"The Newcastle hub is one of the most rapidly growing parts of the firm globally. It is very much about stepping outside the traditional methods of delivery and looking for ways for that service to be standardised and digitised, and to remove unnecessary costs."

Atkins also highlights the firm's use of emerging technology solutions to enhance efficiencies and support different modes of service delivery. This includes the recent launch of "Parker", the first Australian chatbot using artificial intelligence to respond to questions on privacy law, and 'Deliver & Capture' a digital platform that captures contract data to help guide the implementation of infrastructure projects.

Atkins emphasises that while technology is important, innovation around the firm's capabilities and adapting the service offering and diversity of skills and expertise is crucial.

"I don't think we are going to get to the point where you can push a button and technology will have all the answers because clients value human judgement. If you are dealing in the realm of complex, sensitive work for clients it's not just about a technology solution."

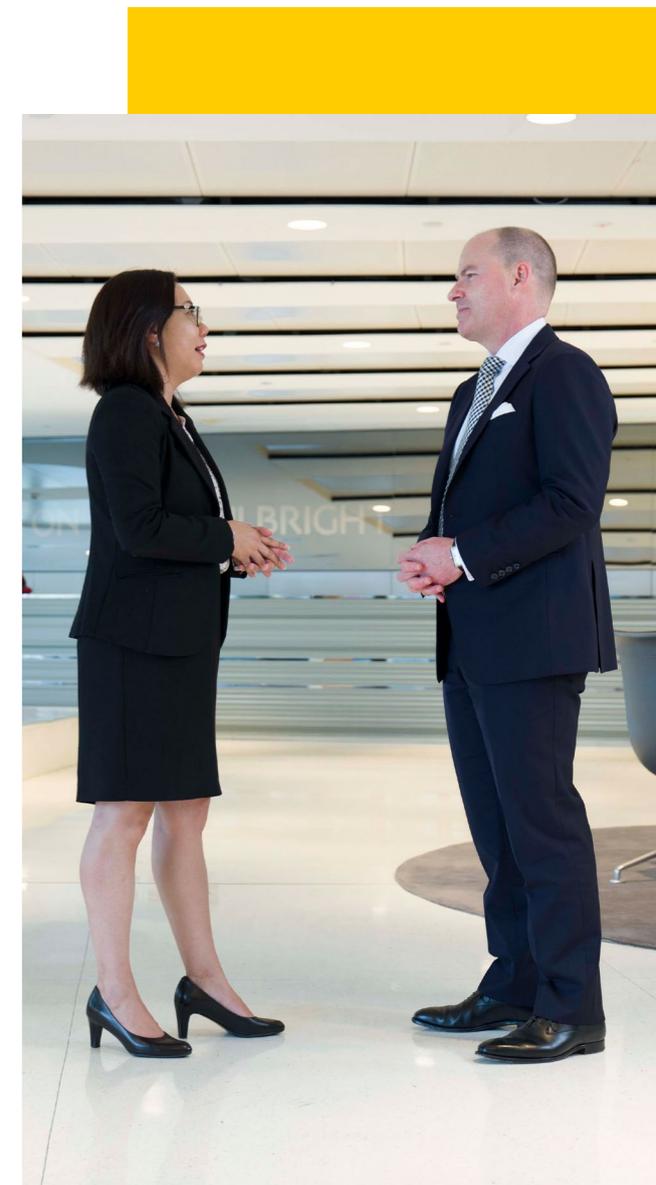
Atkins says that Norton Rose Fulbright's global managing partner recognised that the firm needed to transform the way it engaged with clients. This was based on the notion that the solution to clients' most complex problems isn't always exclusively a legal one.

"We needed to start to imagine our future as lawyers not just delivering legal services in the traditional way we had for the last three or four hundred years."

The firm established a global risk advisory practice which Atkins leads in Australia. It comprises a mix of professionals with legal and non-legal capabilities and a strong pedigree in regulatory strategy, operational risk, compliance and cybersecurity.

"We don't apologise for being a law firm with highly talented lawyers, but we now have a number of professionals who were hired for their subject-matter expertise, not just legal expertise. The benefit of having a diversity of skills and capability at the table is engaging with the Chief Risk Officer or the CEO and COO, not just the general counsel. That's a very different discussion."

"We believe that we are pioneering in this space. Some other firms have non-legal services but that's not our model – its built fundamentally around integrating our subject matter experts with our legal experts as a holistic offering and we can't invest in this quickly enough."





Investment in technology

Closing the technology gap

In pursuit of enhanced client service and a competitive edge, the majority of firms have not only increased their use of technology but are also anticipating further investment in a range of established and emerging solutions.

Increasing comfort in the cloud

Technology has remained number one of the top areas of overall investment for Australian law firms over the last eight years, with almost four in five firms expecting technology budgets to rise further in the year ahead.

When considering this ongoing focus, most firms agree that the adoption of new technology is the result of two dominant drivers – client expectations and keeping pace with competitors.

In the three and a half years since we first asked firms about their existing and expected use of technology, adoption levels have increased in every category, led in most cases by top-tier firms.

The most significant change since 2015 is in the number of firms implementing and frequently using cloud-based solutions, rising from 25% to 39% of all firms over the period. In another sign that any previous aversion to the cloud is abating, a further 32% of firms are currently working to implement cloud-based technology.

The next greatest uplift is in the area of e-discovery, with the proportion of firms bringing this technology in-house, rising from 42% to 54% across the industry. However, while all 10 top-tier firms are frequently using e-discovery tools, adoption levels are more subdued among mid-tier firms.

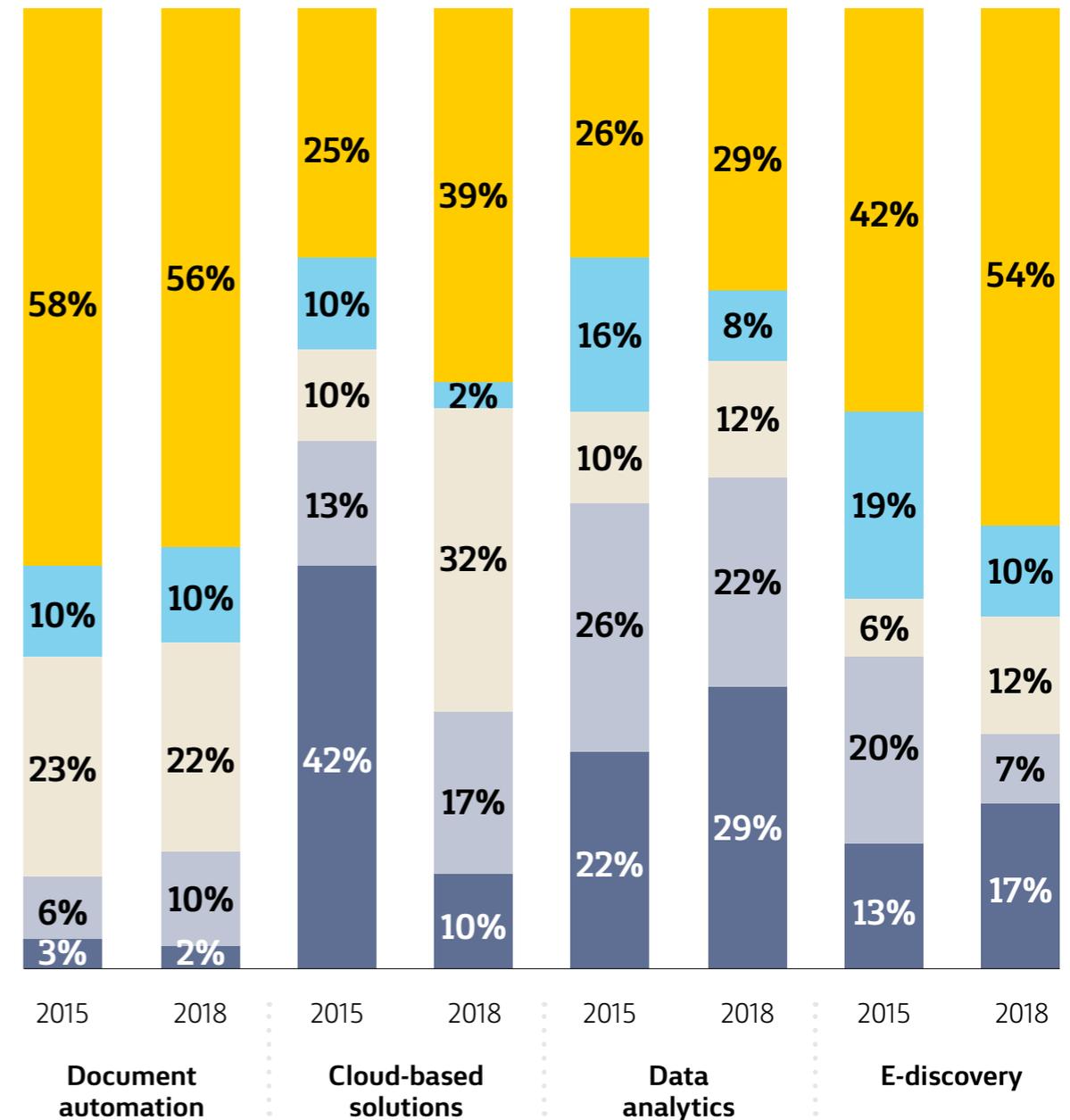
Mid-tier firms also lag their larger rivals in adopting emerging technologies such as blockchain and artificial intelligence. They are, however, more advanced in the area of enterprise social media. In addition, every top-tier and mid-tier firm had, or is in the process of, implementing cyber-security measures.

"We are adopting work flow management, e-discovery, legal process outsourcing (LPO) for efficiencies and [then] pass savings in time and dollars on to key clients."

CFO
Mid-tier firm

Technology adoption

To what extent has your firm adopted and used technology?



- Implemented and frequently use
- Implemented but seldom use
- Currently implementing
- Looking to implement
- Not implemented

Mid-tier firms to ramp up emerging technology

Budgets across all areas of technology are expected to increase in the next two years, with the largest proportion of firms overall seeking to lift spending on data analytics (79%), artificial intelligence (78%) and blockchain solutions (77%).

And while more top-tier firms are currently using these emerging technology solutions, a greater number of mid-tier firms expect to increase related investment compared with top-tier firms.

In fact, mid-tier firms are more likely than top-tier firms to lift technology spending across every category except cloud-based solutions. This suggests that not only are they looking to keep pace with their top-tier rivals, but also to meet an increasingly embedded client expectation for technology leadership, and the associated cost and operational benefits.

While all firms also indicate an improving average Return on Investment (ROI) in technology in the year to date, this is most prevalent among mid-tier firms. Nineteen in 31 mid-tier firms now report a moderate or high ROI compared with 15 of 32 firms a year ago.

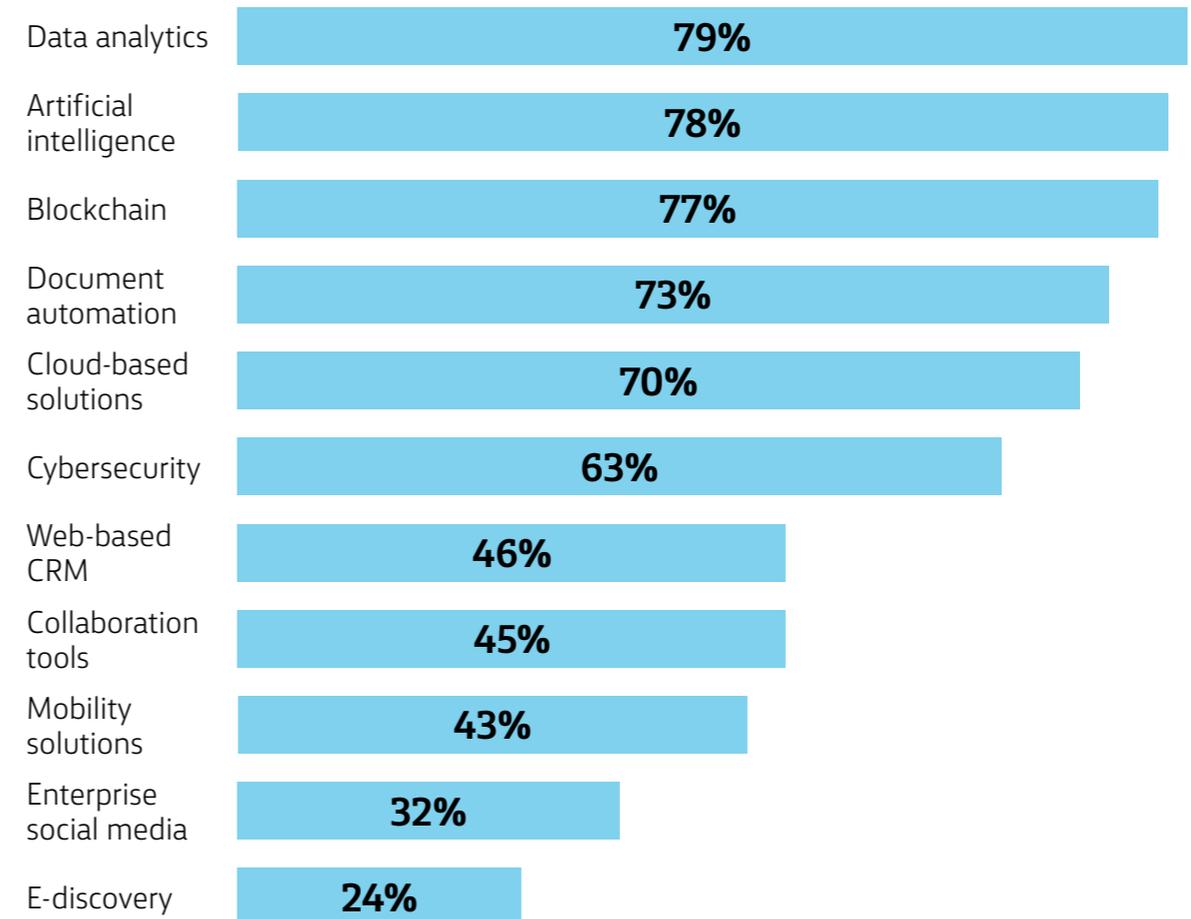
And while top-tier firms have also realised an improvement in the commercial return from technology, a more moderate uplift may reflect the stage of maturity and adoption levels of technology.

"[We] will embrace leading technology solutions to provide an enhanced service to our clients [and] continue to develop 'smart working' initiatives to help attract and retain the best talent and to allow that talent to fully develop and operate in an inclusive, modern, connected world"

Manager
International Top-tier firm

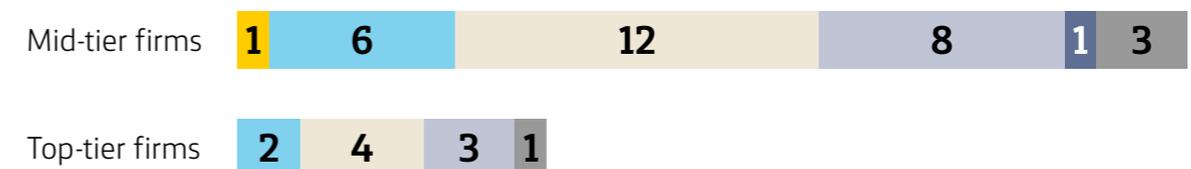
Outlook for technology investment

How do you expect the proportion of your technology budget allocation to change in the next two years?



Return on investment

To what extent have you seen a return on investment in technology?



● Very high return
 ● High return
 ● Moderate return
● Low return
 ● No return
 ● Don't know/Too early to tell

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